

# **Fiscal Research Program**

## **REDUCING THE PROPERTY TAX ON MOTOR VEHICLES IN GEORGIA**

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## **Introduction**

Nothing excites Americans like tax breaks and automobiles. Thus, it is hard to imagine a more potent tax proposal than one which lowers the tax on automobiles. Over the past year, there has been increased interest in Georgia and elsewhere in the idea of sharply reducing the property tax levied on motor vehicles. In 1998, legislatures in four states, Virginia, Missouri, South Carolina, and California proposed bills which would eliminate or reduce the property tax on motor vehicles in those states. With vehicle ownership so widespread, this is an appealing issue.

In 1996 Georgian counties and municipalities collected \$1.8 billion from property taxes levied on tangible real and personal property.<sup>1</sup> \$474 million was collected in property taxes levied on motor vehicles. This compares to total county and municipal sales tax receipts of \$1.4 billion and total taxes and fees of \$52.3 billion. Of the total motor vehicle property taxes in 1996, 28 percent went to county governments, 57 percent to school districts, 14 percent to cities and special districts, and 1 percent to the state.

From a policy standpoint, the rationale for including or excluding motor vehicles in the tax base is mixed. Some may argue that vehicle ownership is a necessity and as such should not be taxed.

Traditionally, items deemed to be necessary for employment are not included in the Federal income tax base, and are usually excluded from state and local sales tax bases. Under current law, Georgia only applies the property tax to 40 percent of the vehicle's market value and allows the

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<sup>1</sup> This amount excludes property tax collections from school districts. It also excludes state property tax revenues of \$38 million.

remaining 60 percent to go untaxed. Thus, it could be argued that the untaxed 60 percent represents the exemption for the “necessary” portion of the vehicle value.

It could also be argued that eliminating the tax encourages motor vehicle consumption at a time when traffic problems in Georgia abound. Because the tax on motor vehicles is small relative to the vehicle value, changes to the tax structure will likely have little direct effect on automobile consumption. It is more likely that individuals will experience a slight increase in their disposable income, and thus, consumption of all items will increase.

From a political standpoint this is a very popular proposal. It is easy for the general public to understand. And with 4.8 million motor vehicles in Georgia in 1997, this issue applies to almost every citizen. In an era of rising automobile prices, proposals which decrease the cost of vehicle ownership should find strong public support.

### **Description of Proposals**

At this time, there are four states, Virginia, South Carolina, Missouri, and California which are proposing to reduce or eliminate the property tax on motor vehicles. Each takes a slightly different approach to the issue. Only the Virginia proposal has been signed into law. The bill passed both the Virginia House and Senate by a unanimous vote and became law in May 1998. Although the South Carolina proposal had strong support in the House, it became bogged down in the Senate. No vote was taken before the close of the 1998 session. The Missouri proposal was not voted out of committee and is not discussed here.

Governor Pete Wilson of California has proposed a reduction in the California property tax on motor vehicles as well. California levies an “in-lieu” property tax under which there exists a state-wide millage rate which is applied to the base of personal property. No details are available for the California proposal at the time this research was conducted.

## Virginia Proposal

The Virginia approach, first outlined by then Virginia gubernatorial candidate Jim Gilmore, eliminates the property tax on the first \$20,000 of value of a motor vehicle. A motor vehicle, for the purpose of this issue, includes all personal passenger cars, motorcycles, and pickup or panel trucks. Commercial cars, fleet vehicles, and business-use autos are not eligible for the exemption. The proposal applies equally to owned and leased motor vehicles and to both new and used vehicles.

The tax reduction is phased-in over a 5-year period according to the following schedule:

Phase-In Schedule	
Year	Percent Reduction
1	12.5 percent
2	27.5 percent
3	47.5 percent
4	70.0 percent
5	100.0 percent

In an effort to protect the fiscal freedom of the localities, the proposal requires that the state reimburse the taxing jurisdictions for the loss in revenue stemming from the reduction in the property tax base. In year one, vehicle owners are reimbursed directly by the state for 12.5 percent of the full exemption amount, which is defined as the value of the motor vehicle up to \$20,000 multiplied by the taxing jurisdiction's 1997 motor vehicle millage rate. Vehicle owners pay their full property tax bill to the local taxing jurisdiction and receive a reimbursement directly from the state. This gives the localities a period of time to implement the appropriate accounting

and record keeping practices required for handling the exemptions. In years 2-5, vehicle owners pay a property tax bill to the taxing locality equal to the tax on the first \$20,000 value of the vehicle times the phase-in percentage, plus the full tax on the value of the vehicle in excess of \$20,000. The taxing jurisdictions are then reimbursed by the state for the lost revenue. However, the reimbursement is always based on the 1997 millage rate, while the tax reduction is based on current millage rates. Local governments would not lose any revenue provided they do not raise millage rates from their 1997 levels.

### **South Carolina Proposal**

The proposal which was before the members of the South Carolina legislature was designed to completely eliminate all property taxes on the class of personal property defined as “all other personal property.” This includes motor vehicles, boats, airplanes, and business personal property.

In this proposal, local government receipts from the personal property tax are capped at their 1998 level. Unlike the Virginia legislation this proposal applies to all vehicles, not only to personal-use vehicles. The proposal also creates a property tax relief fund. The purpose of this fund is to reimburse localities for the loss in revenue stemming from the elimination of the property tax on personal property. Each year the South Carolina Board of Economic Advisors places in the fund 30 percent of all new state revenues plus the total of all amounts previously credited to the fund.<sup>2</sup> In the first year of the plan, the state contributes an additional \$25 million to the fund. Once the fund reaches an amount equal to the 1998 property tax receipts from the newly exempted property, all personal property is wholly exempt from tax. The localities are then

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<sup>2</sup> New revenues are defined as general fund revenues in excess of the previous year's revenues.

annually reimbursed an amount equal to their 1998 property tax receipts on the newly exempted property.

The bill specifies that the Department of Revenue Commissioner calculate and design a local government reimbursement formula. The legislation requires that during the phase-in period, local governments adjust their millage rates such that the sum of current property tax receipts and state reimbursements do not exceed their 1998 property tax receipts. Furthermore, the statute specifically prohibits the taxing entities from adjusting their millage rate to exceed the 1998 rate in an effort to collect additional revenues from a shrinking tax base.

### **Status of Motor Vehicle Taxes in Other States**

Although this issue is gaining some interest among administrators, only twelve states currently include motor vehicles in the personal property tax base: Alabama, Arkansas, Connecticut, Georgia, Kentucky, Mississippi, Missouri, New Hampshire, North Carolina, South Carolina, Virginia, and West Virginia. In these states local governments apply a millage rate to the assessed value of the motor vehicle. The assessed value is legislated to be some percentage of the market value of the vehicle. In addition to these twelve states, there are sixteen states that levy “privilege” taxes instead of property taxes: Arizona, California, Colorado, Indiana, Kansas, Maine, Massachusetts, Michigan, Minnesota, Montana, Nebraska, Nevada, Oklahoma, Utah, Washington, and Wyoming. In these states, the tax rate is uniform across the state and the state collects the revenue and redistributes the revenue to the localities according to a redistribution formula.

## **Revenue Effects of Modifying the Personal Property Tax on Motor Vehicles in Georgia**

The revenue effects of the two proposals discussed above are estimated as if they applied to motor vehicles in Georgia. In each case, it is assumed that the proposal is effective for calendar years beginning after 1998. The estimates are based on 1996 data of motor vehicle property tax assessments obtained from the Georgia Department of Revenue and 1996 motor vehicle property tax receipts obtained from the Georgia Department of Community Affairs.

### **Virginia Proposal**

Under the Virginia proposal, the first \$20,000 of the vehicle's fair market value is eliminated from property taxation.<sup>3</sup> The exempted amount (up to \$20,000 of market value) is then multiplied by the 1998 motor vehicle millage rate in effect in the appropriate jurisdiction to determine the effect on revenue. It was assumed that this proposal would be effective on January 1, 1999.

The estimate represents the cost to the state government, which stems from two sources.

Currently, the state levies  $\frac{1}{4}$  of a mill on the assessed value of all vehicles subject to tax. (This revenue is collected by the counties on behalf of the state.) For 1996 the loss of tax revenue to the state government from the elimination of the property tax on motor vehicles would have been \$3.6 million. The second and largest source of state government cost is due to the reimbursements remitted to the taxing localities. Due to the gradual phasing-in of the reimbursement schedule, the combined cost to the state in the first year is only \$36 million, and constitutes 11 percent of current law revenues (i.e., total property tax paid on all motor vehicles). In year 2003, the state would reimburse the taxing localities 100 percent of the revenue loss. The cost to the

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<sup>3</sup> Since motor vehicles are assessed at 100 percent of market value in Virginia, the original proposal did not distinguish between assessed and market value.

state government of \$261 in year 2003 represents 64 percent of current law revenues. These costs estimates do not include any costs associated with implementation or administration of this program. The following chart illustrates the cost to the state government from the enactment of this legislation.

Cost to Georgia State Government -- Virginia Proposal (Calendar Years/units in Millions)					
<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>Total 99-03</b>
-\$36	-\$74	-\$127	-\$185	-\$261	-\$682

\*Annual amounts may not sum to the total due to the effects of rounding.

When fully phased-in the proposal would completely eliminate the tax on 77 percent of the vehicles currently subject to tax. Assuming a millage rate of 29.5 mills (approximately the state average), a vehicle owner would receive a refund in 1999 of at most \$30. As the exemption ceiling rises in 2000 through 2003, so to does the refund amount. The maximum tax savings an owner can receive (assuming a millage rate of 29.5 mills) in 2000 is \$60, in 2001 is \$112, in 2002 is \$166, and in 2003 is \$237. As vehicle prices increase over time, more individuals will receive the maximum refund because the exemption ceiling is not indexed for inflation. Thus the rise in vehicle prices over time will cause more and more vehicles to have a value in excess of the exemption ceiling. It is estimated that the statewide average refund in 1999 will be approximately \$12, and \$79 in 2003.

### **South Carolina Proposal**



South Carolina's proposal gradually eliminates the property tax on the entire value of all personal and business use motor vehicles; the effect of eliminating other personal property is not considered here. As seen in the revenue estimate presented in the following chart, the maximum reimbursement to the Georgia localities would be \$547 million, which is the estimated 1999 property tax receipts from motor vehicles in Georgia. When fully phased-in, this proposal will eliminate the tax on over 5 million personal and business use vehicles.

Revenue Effect -- South Carolina Proposal (Calendar Years/units in Millions)					
<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>Total 99-03</b>
-\$189	-\$362	-\$525	-\$547	-\$547	-\$2.169

\*Annual amounts may not sum to the total due to the effects of rounding.

### **Administrative Issues**

The administrative issues associated with these proposals will vary depending on the proposal adopted. Many of the issues discussed below are based on the experience of implementing the Virginia proposal.

One issue which is relevant to all proposals which limit the tax break to personal use vehicles involves the determination of eligibility. One solution is to rely on the definition used for the Federal tax deduction for business use vehicles. Simply put, if a vehicle owner takes a Federal tax deduction for business use of the vehicle, then the vehicle is not eligible for the state tax break on property taxes. This means though that the Department of Revenue must have a means of

verifying this status. This could be done by requiring a copy of the Federal tax return, or by random audits. Both options have drawbacks, but without a means of verifying eligibility inappropriate vehicles may receive the tax break.

This issue becomes particularly problematic in the case of leased vehicles. Many of these vehicles have their property tax bill paid by the leasing company. Thus, these property tax proposals require that the leasing companies notify the Department of Motor Vehicles of those vehicles which are for personal use. This is information which is not currently collected and places a potentially great burden of proof on the leasing company.

The Virginia experience brought to light two other issues. The first was that not all the taxing jurisdictions had the same fiscal year for their budget process. This creates some difficulty in terms of reporting and reimbursements. The second is that the Virginia legislation requires input from both the county treasurer and from the county commissioner, each of whom are elected officials and sometimes of different political parties. It has been the experience in Virginia that there are often no existing lines of communication between these officials. Thus, this legislation forces new communication and cooperation between groups within the government.

In addition to these issues, the sheer number of taxing jurisdictions in Georgia (well over 1,000) will cause a paperwork and tracking ordeal. The Virginia legislation includes some funds to bring electronic information transfer to the local taxing jurisdiction. This will aid the state in determining the appropriate amount of reimbursement, and also in their audit procedures.

Furthermore, there currently exist several districts in Georgia which assess property at values other than 40 percent. Since the Virginia proposal bases reimbursements on the millage rate, these millage rates in Georgia localities that use assessment ratios other than 40 percent must be adjusted to reflect an assessment practice of 40 percent.

All of these issues are solvable, but the state and local governments will need additional resources in the form of larger staff and computers to audit, track, collect and transfer the needed information to the state level.

### **Conclusion and Policy Recommendations**

The analysis above outlines several proposals to eliminate or reduce the property tax on motor vehicles and the revenue consequences associated with each. It is clear from the analysis that the goal of reducing or eliminating the tax can be achieved relatively easily. The Virginia and South Carolina proposals offer well constructed models for other states to follow. While in each case there exist some problems with implementation, these can be overcome with advanced preparation and greater information.

The results of such a tax modification will vary over time and across districts. A reduction in the tax will likely not result in an increase in motor vehicle consumption, an effect lawmakers would be careful to avoid in light of the air quality issues and traffic problems facing metropolitan Atlanta. While this is a somewhat visible tax, the most probable short run result would be an increase in general consumption since most individuals do not take the tax into account when purchasing a motor vehicle.

Reducing or eliminating the tax will in the short run reduce the tax bill of state residents in a visible and straightforward manner. On the other hand, the long run consequences of a reduction or elimination may be quite different. To the extent that local governments are not fully reimbursed by the state for the lost revenue, this type of proposal will in all likelihood have no effect on the overall level of local taxes paid by the general population in the long run. Since these proposals are not linked to any mandate or even request to reduce local government

spending, local government budgets are not likely to shrink. In fact, reductions in Federal transfers to states and localities are putting increased pressure on local government budgets. Curtailing the localities's ability to tax motor vehicles and not fully reimbursing local governments will force these entities to seek new sources of revenue or to increase the use of existing ones. Under the Virginia plan, the localities could simply increase the millage rate which applied to the remaining taxable property, including housing. The South Carolina proposal eliminates this alternative by completely eliminating the personal property tax base and freezing the levy on other property.<sup>4</sup>

In addition to limiting the tax base of all localities, the modification to the property tax base will affect some localities more than others. If state reimbursements are tied to historical revenue collections there is no accommodation made for future growth. Thus, small and currently less developed counties will be at a disadvantage relative to counties which are closer to their population capacity. In the Virginia proposal state reimbursements are based on the locality's millage rate in the initial year. While millage rates do rise and fall from year to year, over time these rates tend to follow an upward trend. Therefore, over the long run localities will likely face a decreasing reimbursement in real terms.

Lastly, incursion of the state into the taxing domain of the localities is likely to meet with opposition from local public officials. Although localities are granted the privilege of taxation from the state, many local officials will see this effort to reduce the public's tax burden as an effort to erode the localities's power. This will increase tension on intergovernmental relations at a time when the state and localities need to come together to face common issues. This would be

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<sup>5</sup> The proposal affects all personal property in the category of "all other personal property" but does not include housing.

a costly waste if in fact in the long run the modifications to the motor vehicle tax do not reduce the tax burden of the individual.

### **About the Author**

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